

TO: Board Members

THROUGH: Kevin Patteson, Executive Administrator

FROM: Amanda Landry, Development Fund Manager

DATE: November 19, 2014

SUBJECT: Consider adopting resolutions and approving a Preliminary Official Statement for Water Financial Assistance Bonds; the selection of additional underwriters, the enhancement of the fee cap for bond counsel, the authorization of the Executive Administrator to take all necessary action on behalf of the Texas Water Development Board related to the sale and delivery of multiple series of Water Financial Assistance Refunding Bonds

ACTION REQUESTED

Consider approving by resolution: (a) the Preliminary Official Statements; (b) additional underwriters; (c) authorizing the Executive Administrator to compensate bond counsel under an enhanced fee cap pursuant to the applicable outside counsel contract, and (d) authorizing the Executive Administrator and Development Fund Manager to act on behalf of the Texas Water Development Board in the sale and delivery of multiple series of Water Financial Assistance Refunding Bonds.

BACKGROUND

On September 18, 2014, the Board authorized staff to prepare for the issuance of up to \$187,215,000 in Water Financial Assistance Refunding Bonds for the currently callable bond series. Staff and tax counsel have completed the diligence on the callable series. Some series are eligible in part for tax-exempt financing while others are ineligible. Table 1 on the next page summarizes the analysis and the bonds available for refunding and the recommended tax status of the proposed bonds.

Table 1

Series	Program	Original Tax Status	Principal Outstanding	Percent Allocation	Refunding Tax Status
2004 A	WDF	AMT	\$ 22,270,000	100.00%	Taxable
2004 B	WDF	Tax-Exempt	20,280,000	19.87%	Tax-Exempt
				80.13%	Taxable
2004 C	EDAP	Tax-Exempt	17,730,000	59.18%	Tax-Exempt
				40.82%	Taxable
2004 D	WDF	Tax-Exempt	50,490,000	59.18%	Tax-Exempt
				40.82%	Taxable
2004 E	WDF	Taxable	13,565,000	100%	Taxable
			<u>\$ 124,335,000</u>		

Staff with assistance from the financial advisor, has analyzed the underlying borrower loans to identify their call dates and analyze potential for prepayments. Based on this analysis and given the history of prepayments in the Water Financial Assistance Fund, Staff is recommending a Plan of Finance that includes the utilization of soft put bonds to provide the Board a more flexible alternative to applying prepayments when received. The proposed Plan of Finance incorporates a balanced composition of fixed rate bonds and soft put bonds to strive for a structure that minimizes interest rate risk while allowing a new alternative to accommodate borrower prepayments. Based on the separate programs, tax status and debt instruments, there are proposed three (3) separate series with six (6) different subseries of bonds. Table 2 below highlights the resolutions recommended.

Table 2

DFund	Series A	Tax-Exempt	Fixed	A1
			Soft Put	A2
	Series B	Taxable	Fixed	B1
			Soft Put	B2
EDAP	Series C	Tax-Exempt	Fixed	C1
		Taxable	Fixed	C2

In an effort to reduce the cost of issuance and maximize savings, the refunding bonds are being combined into one transaction and will be sold under one Preliminary Official Statement which will consist of the three (3) separate series and six (6) subseries as identified above. The required documents have been drafted in coordination with the consultants: Norton Rose Fulbright,

Escamilla and Poneck, and FirstSouthwest. Documents attached for your review include the Bond Resolutions and the Preliminary Official Statement.

Advisors

FirstSouthwest is serving as financial advisor, Norton Rose Fulbright as bond counsel and Escamilla & Poneck as disclosure counsel. Part of this agenda item is requesting Board consideration in authorizing the Executive Administrator to compensate bond counsel under an enhanced fee cap pursuant to the applicable outside counsel contract

Underwriters

On September 18, 2014, the Board selected Morgan Stanley as the senior managing underwriter. Given the proposed Plan of Finance, which includes the utilization of soft put bonds and the projected par amount of some of the proposed bond series, the overall transaction does not lend itself to a traditional underwriting syndicate. Therefore, the Executive Administrator recommends the firm of Coastal Securities as the co-senior manager on the transactions.

State Debt Authorization

Staff will be submitting the debt application to the Bond Review Board and anticipates receiving approval in advance of pricing. Legislative Budget Board approval is not required for this transaction. No constitutional authority is anticipated to be utilized with this transaction.

SAVINGS ANALYSIS

The refunding of the identified bonds provides debt service savings for the Economically Distressed Areas Program and the Development Fund Program. The projected savings, summarized below, are included in the debt service schedules provided in Attachment 5. As noted in Table 3, the net present value (NPV) savings exceed the TWDB's Debt Management Policy minimum threshold of 2.00% based on current market rates. If market rates change, the refunding bonds will not be issued unless the minimum threshold is met.

Table 3 ⁽¹⁾

Program	Proposed Series	Par To Be Refunded	NPV Savings (\$)	NPV Savings (%)
DFund	Series A	\$ 33,835,000	\$ 7,807,435	23.07%
	Series B	\$ 72,770,000	\$ 7,408,901	10.18%
EDAP	Series C	\$ 17,730,000	\$ 1,725,042	9.72%

(1) Preliminary subject to change.

Understanding the interest rate risk that exists when the soft put bonds reach their mandatory tender date, a calculation has been performed to determine how much interest rates on the soft put bonds could rise and still achieve 2.00% net present value savings, consistent with the TWDB's Debt Management Policy. On the Series 2015A Tax-exempt Bonds, interest rates

could rise 4.68% and on the Series 2015B Taxable Bonds, interest rates could rise 5.98%. Additionally, a breakeven analysis was undertaken to determine how much interest rates could increase and still achieve the same debt service savings as if the TWDB had utilized a similar structure to prior refinancings, fixed rate bonds with a three (3) year call option. On the Series 2015A Tax-exempt Bonds, interest rates could increase 3.79% and on the Series 2015B Taxable Bonds, interest rates could increase 2.73% to achieve a breakeven savings level.

USE OF PROCEEDS SAVINGS ANALYSIS

The net proceeds of the refunding bonds will be: (a) deposited with the Paying Agent and used to redeem the refunded bonds identified above and (b) used to pay the costs of issuance.

COST OF ISSUANCE

Based on the estimated par amount of the refunding bonds, the costs of issuance for the combined transactions have been estimated at a not-to-exceed cost of \$5.00 per bonds for the underwriter's discount and a maximum of \$490,000 for all related costs (i.e. bond counsel, disclosure, financial advisor, bond ratings, Attorney General, paying agent/registrar and other miscellaneous fees and expenses). The estimated fees and expenses are in line with market and other similarly sized and structured bond transactions and are detailed in Attachment 6. The fees and expenses may be negotiated further based on market conditions at the time of pricing.

SCHEDULE OF EVENTS

The Schedule of Events has been provided as Attachment 7. Staff anticipates pricing the bonds January 13, 2015 and closing the transaction on February 5, 2015.

STAFF RECOMMENDATION

The Executive Administrator recommends adoption of the resolutions for the Series 2015A, Series 2015B and Series 2015C, approving and deeming final a Preliminary Official Statement to be used in the marketing of the refunding bonds; the selection of Coastal Securities as co-senior underwriter; authorizing the Executive Administrator to compensate bond counsel under an enhanced fee cap pursuant to the applicable outside counsel contract, and authorizing the Executive Administrator and Development Fund Manager to act on behalf of the Texas Water Development Board in the sale and delivery of multiple series of Water Financial Assistance Refunding Bonds.

CERTIFICATION

This recommendation has been reviewed by legal counsel and is within the Agency's legal authority.

Les Trobman, General Counsel

Attachments:

- 1 – Tax-Exempt Series 2015A Bond Resolution
- 2 – Taxable Series 2015B Bond Resolution
- 3 – Series 2015C (Economically Distressed Areas Program) Bond Resolution
- 4 – Draft Preliminary Official Statement
- 5 – Preliminary Debt Service Schedules and Savings Analysis
- 6 – Estimated Costs of Issuance
- 7 – Schedule of Events